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TAX

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Energy & Natural Resources

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Introduction

For the KPMG network, a top priority is helping member firm clients manage tax transformation and position their businesses for future success. Since 2006, we have conducted regular surveys of tax executives around the globe to uncover their most pressing issues. Our purpose is to gain insights on how these issues influence changes in structure, investments in people and processes, and overall objectives and priorities.

Now, in this updated survey conducted in late 2012, the environment in which tax directors operate has changed dramatically. Lingering economic uncertainty is increasing pressure on companies to cut costs and on tax authorities to boost revenue. Globalization continues to spur centralization of finance, tax and other functions. Companies are expected to improve their governance, accountability and transparency in all areas. Further, political attitudes toward taxation are shifting, with much more focus on civic responsibility and public demands that companies should pay their "fair share" of tax to the jurisdictions where they earn profits.

With this environment as a backdrop, we sought to identify trends and benchmarks on the following fundamental questions:

- How are tax departments changing their operations to address emerging economic, business and regulatory trends?
- How are they progressing on aspects of governance and performance such as strategy, risk management and measurement?
- How are they approaching process and technology investment and improvement, including the impact of cloud computing?
- How are they addressing the pressure to more effectively resource how they do their work?
- How are they responding to rising tax authority scrutiny and demands?

The survey now shows that tax departments have made good progress in several of these key areas. However, in a rapidly changing business and regulatory environment, the results also suggest that there is still work to do if tax departments are to meet the dual challenges of effectively managing risk while providing more effective, real-time support to business activity and influence on the bottom line.

Focus on Energy & Natural Resources

Based on KPMG International's survey of tax executives, tax departments of multinational companies in the Energy & Natural Resources (ENR) sector are:

- **gaining interest and guidance from boards and corporate leadership** in the development of tax department strategies that align with the company's overall business strategy, in part due to rising regulation of the sector globally
- **centralizing the management and structure of resources in global or business-wide headquarters tax departments** to improve accountability, control and standardize approaches
- **well advanced in their efforts to standardize tax department roles and processes** and putting priority on investments in improving their tax and finance function processes and controls in order to meet more extensive tax, financial and non-financial reporting demands
- **less likely than their peers in other industries to use outsourcing, co-sourcing and shared service centers** to carry out or support tax department activities, partly due to highly specific and complex ENR tax regimes
- **putting more emphasis on compliance-related activities than on improving connectivity** with other parts of the business and other, more strategic pursuits
- **in need of further investments in improving processes and technology** to keep pace with rising tax compliance audit demands while freeing tax department time to engage in more strategic pursuits that influence the bottom line.

KPMG's series of benchmarking studies of tax department structures and operations shows that leading tax departments—those that add the most value to their businesses—do so by putting high priority on three areas:

1. ensuring clarity of accountabilities
2. driving standardization and efficiency
3. promoting connectivity with their colleagues across the business through a proactive, outward-reaching tax department.

In conducting the survey in late 2012 on behalf of KPMG's member firms, we were keen to see how tax departments have progressed in these areas, especially given ongoing economic uncertainty and continuing regulatory reform.

This report highlights insights on how tax departments of companies in the ENR sector have advanced since our last survey in 2009. For analysis of the global survey results, visit kpmg.com/goodbetterbest.

Clarity of accountabilities – tax complexity and risk commands boards' attention

More than most industries, the global ENR sector has long been subject to high degrees of oversight, regulation and control, which are needed to ensure economic efficiency and to protect consumers, the environment, and security of supply. To succeed under such heightened supervision, ENR companies have needed to establish strong processes and systems to meet regulations related to health, safety, environmental and security aspects of upstream and manufacturing operations, as well as internal and external financial, corporate governance, information security and compliance aspects.

Over the past few years, regulation of the sector has increased across the globe, with new tax and financial reporting regimes such as:

- the US Dodd-Frank Act's rules requiring greater financial transparency in the extractive industries
- new requirements to report payments to governments (including tax) under anti-bribery and corruption rules such as the Extractive Industries Transparency Initiative
- the European Commission's proposed country-by-country reporting system, including tax payments, for EU-listed and EU privately owned large extractive and logging companies.

Investors, regulators and other stakeholders have sharpened their focus on tax controls and governance, and reputational risk related to tax has grown more important. Resource taxes are rising as governments seek to increase their shares of revenue from their countries' resource bases and/or impose "green taxes" to reduce environmental harm and support the development of sustainable alternatives.

In this context, it is not surprising that boards and corporate leadership of ENR companies are attentive to risk and how it is managed within their companies—whether that risk is related to tax or a host of other issues. As part of this oversight, previous KPMG tax department benchmarking studies have shown that leading tax departments put priority on ensuring that roles and responsibilities are clear and commonly understood within the context of a company-wide, board-approved tax governance framework. In fact, the top three companies in the Transparency International report 2012 "Transparency in Corporate Reporting: Assessing the world's largest companies" are three ENR companies.[1]

Survey results show that boards and corporate leadership of most ENR companies are clearly focused on the management of tax. Currently, 93 percent of ENR respondents say their company has a tax department strategy that is consistent with the company's overall business strategy. For 76 percent of respondents, the board and/or corporate leadership are directly involved in providing guidance on the tax strategy. Similarly, 74 percent of respondents report that their board has approved the tax strategy.

According to respondents, ENR companies are more likely than their global counterparts in other industries to document their tax department and risk management strategies, which is important for ensuring strategies and policies are followed: 71 percent of ENR tax departments have formally documented their tax strategy, compared to 62 percent in other industries, and 75 percent have formally documented their company's approach to managing tax risk, compared to 70 percent in other industries.

Survey results suggest that tax departments' primary focus is on day-to-day compliance work. ENR respondents say that accurate and timely tax return compliance is the most important activity driving tax department objectives, followed closely by accurate and timely financial reporting. These are the most likely activities to have key performance indicators assigned to benchmark and measure tax department performance.

93%
of ENR respondents have a tax department strategy that aligns with their overall business strategy

76%
say their board and/or corporate leadership provide direct guidance on the tax strategy's development

1 Transparency in Corporate Reporting, www.transparency.org, 2012, Transparency International.

Additionally, in most parts of the world, tax audit and controversy activity is increasing markedly, drawing more board-level attention toward the company's tax affairs. Currently, 58 per cent of ENR respondents are involved in some form of tax controversy. For example:

- 36 per cent are involved in indirect tax (sales/use or VAT/GST) controversy
- 34 percent of ENR respondents say they are currently involved in corporate income tax controversy
- 27 percent are involved in disputes involving people taxes (social security, personal income taxes, etc.)
- 23 percent are involved in disputes involving transfer pricing.

In the future, tax controversy may rise even higher. ENR respondents report that the tax authorities are becoming more focused on auditing not only corporate income and indirect taxes but also tax and accounting processes and controls. As ENR companies in many parts of the world are traditionally subject to higher-than-usual audit activity, this shift in focus by tax authorities is more noticeable for companies in this sector.

Another aspect of good tax governance is establishing a tax department structure that aligns to the company-wide strategy and includes clear reporting lines and accountabilities. Seventy-three percent of ENR respondents have established global standards related to tax policies and procedures.

To improve accountability, control and standardized approaches, many ENR companies have been centralizing the management and structure of resources in global or business-wide headquarters tax departments. Currently, 77 percent of ENR respondents say that their tax department is directed, managed or coordinated from their global headquarters.

Just over half of ENR respondents say they have 10 or fewer full-time employees in their tax departments globally, while another 10 percent have 11 to 20 full-time tax employees. Additionally, 53 percent have employees with tax responsibilities for particular regions or multiple countries, 49 percent have employees responsible for single countries, and 60 percent have employees with responsibilities for business units or divisions. Surprisingly, approximately 30 percent of the respondents were unaware of the head counts and structures of their in-house tax departments.

58%
of ENR tax departments are involved in some form of tax controversy

73%
of ENR respondents have global standards related to tax policies and procedures

77%
have a headquarters tax department that directs, manages or coordinates global tax department activities

Driving efficiency – pursuing tax process & control improvements

Historically, ENR companies have faced significant pressure from internal and external stakeholders to provide timely and accurate reporting of tax and financial data.

Survey results show that tax departments of ENR companies are actively working to make their global tax processes and controls more uniform. The majority of ENR respondents rate the levels of standardization of their tax controls, policies and procedures as "standardized" or "very standardized"—and these ratings exceed those of other industries. Responsibilities and accountabilities of tax personnel are the most standardized areas for ENR respondents, followed by controls, learning and development and career paths.

More than half of ENR respondents report standardization of tax compliance activities across the annual cycle — from forecasts of tax expense and annual provision processes through to compliance and tax return processes. However, other tax department processes and technologies beyond the compliance cycle are the least likely to be standardized.

As another indicator of progress on standardization, many ENR tax departments are making investments in improving their tax and finance function processes and controls. For example, 62 percent are undertaking or planning to undertake process-related improvements, 61 percent are providing better training for existing staff, and 58 percent are conducting overall tax strategy and operational reviews.

However, harnessing additional tax technology and process improvements is not high on the agenda for most ENR respondents. Significantly more ENR respondents say that the level of investment in technology and tax process improvement in their tax department is "about right"—82 percent, compared to 73 percent of respondents in other industries. Given that levels of standardization are lowest for tax processes and technologies, that the majority of time is spent on compliance and reporting, and rising demands for ENR companies to report more extensive tax and other data, we would expect less satisfaction with current levels of investment.

ENR respondents are less likely than their peers in other industries to use outsourcing, co-sourcing and shared service centers to carry out or support tax department activities. ENR companies have more difficulty outsourcing tax activities because they are subject to complex, sector-specific taxes (e.g., energy, mining and petroleum taxes) that require specialized knowledge. Nevertheless, ENR companies may be missing opportunities to use outsourcing strategically to free up in-house resources for other activities and to access best practices and investments in people, processes and technology that cannot be developed in-house.

Currently, 30 percent of ENR respondents use outsourcing to support tax department activities, compared with 35 percent of other industries; 30 percent use a finance or accounting shared service center to support the tax department (31 percent in other industries), and 22 percent rely on other finance resources (25 percent in other industries).

Corporate income tax compliance is the most outsourced tax function among ENR companies, followed by tax controversy support and tax planning and business support. Improved management and visibility over compliance activities is considered as the most important characteristic guiding decisions over what ENR tax department activities to outsource, followed by access to compliance technologies and lack of availability of internal resources to complete work.

49%
of ENR tax departments' time is expected to be spent on tax compliance, reporting, managing tax audits and managing tax risk in next 12 months

Promoting connectivity — compliance focus takes precedence

As in other industries, tax departments of ENR companies put more emphasis on compliance-related activities than they do on improving interaction with other parts of the business. While compliance is crucial, KPMG International's research shows that connectivity is important for tax departments to achieve their full potential as contributors to business strategy and drivers of value.

In the next 12 months, ENR respondents expect financial reporting and tax return compliance to occupy 21 percent and 17 percent of tax department time respectively. Managing tax authority audits is expected to occupy 11 percent of tax department time.

78%
of ENR respondents say their administrative budget is sufficient

However, only 7 percent of tax department time is expected to be spent on integration with business groups and early identification of non-routine transactions. Other strategic activities of optimizing the effective tax rate and cash tax planning/tax deferral are only allocated 11 and 10 percent respectively.

19%
expect their tax department to be restructured in the near future

In light of rising tax audit scrutiny and controversy in most markets, it seems likely that ENR tax departments will have to devote even more time to compliance and managing tax audits in the future than they do now. They will also need to improve the efficiency of their data collection and extraction capabilities as new tax, financial and environmental, sustainability and governance (ESG) demands continue to rise. As a result, they could soon have even less time and resources to devote to more strategic pursuits.

However, as with companies in other industries, most ENR respondents appear satisfied with the current situation: 78 percent of them believe their administrative budget is sufficient, and, as noted, most believe the level of investment in technology and tax process improvement in their tax department is "about right". Only 19 percent of ENR respondents expect their tax department structure to change in the near future. Improving alignment of the tax department with the business or finance function is the least common reason given for the expected change.

Respondents name reducing costs and increasing/improving controls as the primary reason about twice as often, which highlights the high priority that ENR companies place on compliance and efficiency to meet their sector's extreme regulatory demands.

For ENR companies seeking to derive the most value from their tax departments, the satisfaction with their current tax department budget and structure appears to be misplaced. Further, without additional investment in tax process improvements and automation, there will be increasing challenges for tax departments as rising tax complexity and pressure to reduce costs continues to mount.

As a result, ENR tax departments will be constrained in their ability to provide effective, real-time support to business activity and influence the bottom line. By investing in additional standardization, process improvement and tax technology, ENR companies will be better able to boost efficiency, keep up with their compliance demands, while improving the ability of their tax teams to collaborate with the peers in other departments and add greater value.

Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organizations are seeing that a transformational approach can show the way forward. KPMG International's research has distilled the following steps as crucial elements in a tax department's blueprint for change.

1. Establish a **common purpose** by aligning strategic goals and objectives of the tax department with those of the wider company.
2. Define **one view of performance** to monitor effective tax management by clarifying requirements and how performance is measured and valued, through agreed-upon KPIs.
3. Ensure the tax department has **high-performing teams** with the right number of tax professionals and the right mix of training, skills and experience.
4. **Embed processes** to realize the tax management strategy in a way that is measurable and sustainable for the long-term.
5. Set systems and procedures to produce, exchange, and distribute **timely and accurate information** to the right people, at the right time, and in the right format.
6. Employ **enabling technologies** (e.g. enterprise resource planning systems, tax software) to automate labor-intensive processes that consume resources and increase risk.
7. **Influence stakeholders** by understanding their goals and constraints and communicating with them to help achieve the goals.
8. Set processes and priorities and align the tax department's structure to promote **connectivity and collaboration** between tax teams and other departments.

About the survey

- KPMG International's global survey of people in charge of tax policy and operations of businesses worldwide is one of the largest surveys of its kind.
- Iterations of the survey have been conducted regularly since 2006, charting the evolution of leading tax departments and identifying operational benchmarks for high-performing tax teams.
- For the 2012 survey, 1,150 heads of tax in 22 countries, including 177 respondents in ENR companies, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 of respondent companies are Fortune 500, Forbes 2000 or equivalent companies.
- To gain more clarity on the telephone survey results, additional in-depth interviews were conducted with several clients of KPMG member firms and tax professionals worldwide.

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